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Hyster-Yale Materials Handling, Inc. (HY)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, welcome to the Hyster-Yale Materials Handling 2023 First Quarter's Earnings Call. My name is Glenn, and I'll be the moderator for today's call. [Operator Instructions]

I will now hand you over to your host, Christy Kmetko, to begin. Christy, please go ahead.

Christina Kmetko

Investor Relations Consultant, Hyster-Yale Materials Handling, Inc.

Thank you. Good morning, everyone, and thanks for joining us today. Welcome to our 2023 first quarter earnings call. I'm Christina Kmetko, and I'm responsible for investor relations at Hyster-Yale. Joining me on today's call are Al Rankin, Chairman and Chief Executive Officer; Rajiv Prasad, President; and Scott Minder, our Senior Vice President, Chief Financial Officer and Treasurer.

Yesterday evening, we published our first quarter 2023 results and filed our Form 10-Q, both of which are available on our website. Today's call is being recorded and webcast. The webcast will be on our website later this afternoon, and available for approximately 12 months. Our remarks that follow, including answers to your questions, contain forward-looking statements. These statements are subject to several risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements made here today. These risks include, among others, matters that we've described in our earnings release issued last night and in our Form 10-Q and other filings with the SEC. We disclaim any obligation to update these forward-looking statements, which may not be updated until our next quarterly earnings conference call, if at all.

With the formalities out of the way, I'll turn the call over to Rajiv.

Rajiv K. Prasad

President, Hyster-Yale Materials Handling, Inc.

Thanks, Christy. And good morning, everyone. I'll start by providing the operational perspective and some color commentary on our market. Scott will follow with detailed financial results and outlook, and Al will close the call with strategic perspective and take us into Q&A.

We had a very strong first quarter. I mentioned on our last quarterly call that we expected to build on our fourth quarter 2022's momentum, and we did. In fact, we did better than we expected in the first quarter. While Scott will cover the financial details, I'll share some highlights from my perspective. Revenue and consolidated operating profit increased very significantly over 2022's first quarter results. Our first quarter profits were driven by improving product margins from more favorable material costs and a strong mix of products and parts. These positive changes more than offset the negative impact from unfavorable currency movements and ongoing supply chain constraints.

Third-party component shortages and related production impacts remain a headwind, but have moderated compared to prior year. Our first quarter unit shipments increased more than 5% from first quarter 2022, primarily as a result of fewer component shortages. However, our factories experienced multiple production setbacks due to ongoing skilled labor availability issues, particularly in the Americas, coupled with shortages of specific components, primarily in Europe. These challenges resulted in our plants falling short of the planned production rate increase targets.

Looking ahead, we are planning for an improving production cadence in the Americas, but labor challenges could alter those plans. In Europe, specific components supply constraints and to a lesser extent labor challenges are likely to negatively impact their production rates in the second quarter. As these issues abate, we expect production and shipment rates to increase rapidly. For the full year 2023, we anticipate very strong production and shipment volumes, which we expect to exceed 2022 levels, despite the ongoing production challenges.

In the first quarter, material and labor costs continued to increase compared to prior-year levels, primarily in EMEA, but the rate of increase slowed substantially. Forward economic indicators suggest more moderate 2023 cost inflation trends. As previously shared, we've implemented multiple price increases over the past two years to offset persistent inflation. We have gained ground in the Americas, and we expect this moderating cost inflation to help drive increased margins, particularly in EMEA. We'll continue to monitor our material and labor costs closely, including the potential impacts from tariffs, and we'll adjust pricing as needed to maintain momentum towards our long-term unit margin goals.

Shifting to our global market expectations, demand for lift trucks remains strong. The latest available data shows that fourth quarter 2022 market volumes were down significantly from the peak levels reached in the first quarter of 2022. Our internal market estimates indicate that the decline seen in the last three 2022 quarters continued in the first quarter of 2023 across all geographic regions. These declines appear to be more moderate than initially anticipated, reflecting more resilient global demand across a variety of industries and markets.

Looking ahead, we expect the broad lift truck market to decrease in each of the remaining 2023 quarters compared to the prior-year quarter. Despite these declines, market should remain strong when compared to pre-pandemic standards in all region, except EMEA. Lift truck bookings decreased significantly in the first quarter compared to robust prior-year levels. Several factors contributed to the decline. First, the global market declined compared to record high prior-year levels. Second, we remained focused on booking orders with solid margins. And lastly, because of our lengthy lead time caused by our high backlog level.

Substantially, booking increased modestly – sequentially, bookings increased modestly compared to the fourth quarter, largely led by the Americas. Looking forward, we expect the lower year-over-year booking trend to continue due to slowing global economic activity in 2023 and a return to more normalized market levels. We'll remain focused on booking higher margin orders. As the year progresses, we'll work to balance our booking rate and production lead times on a line-by-line basis to maximize profitable growth.

With the combination of increasing production and lower bookings, we reduced our backlog by an additional 3% from fourth quarter 2022, but it still remains well-above historic levels. Our continued diligence over booking margins, along with building out and shipping older, lower-margin units, has led to higher average unit margins in our remaining backlog. Our efforts are paying off. In the first quarter, the average sale price for a backlog unit increased by nearly 34% year-over-year, and about 2% sequentially. We expect these positive margin trends to continue in 2023 and into 2024 as we produce the remaining aged backlog units over the next few quarters.

While global economic signals are mixed regarding the likelihood and depth of a recession, our current backlog of higher-margin trucks extends through 2023 production schedules and into 2024. This provides a shock absorber if bookings decline more sharply than expected in 2023.

I'll summarize my comments by saying we expect higher production and shipment rates over the next several quarters, largely due to improving component and labor availability. We remain focused on mitigating the impacts of our continuing supply chain and manufacturing challenges. Our teams are working closely with our suppliers to obtain what's needed for production when it's needed. As our planned production rates increase across 2023, we expect the higher unit price and margin built into our backlog to support a continued improvement in our financial results. Ongoing discipline over bookings, margins and cost structures will support this profitability improvement trend over the longer term.

We expect unit backlog and extended lead times to decrease across 2023, but remain above preferred levels. While we work towards our desired backlog levels and lead times, we remain focused on profitability and cash generation.

Before I turn the call over to Scott, I'd like to highlight a significant recent announcement. In March, we launched a new brand identity for our Yale business. Our Yale brand has had a solid position in the warehouse segment, while our Hyster brand has had a strong position in industrial and port segments. This reflects a core marketplace differentiation between the two brands, and one now being enhanced by new technology. As a result, we have rebranded Yale as Yale Lift Truck Technologies. This new identity and new logo emphasize our focus on solving the toughest labor, safety and productivity challenges in the fast-paced, fast-growing warehouse markets.

Yale Lift Truck Technologies will couple technology integration with a customer-focused philosophy, designed specifically to address the customers' application needs. I'd like to thank the team that steered this project from concept through launch at the recent ProMat Trade Show. It was a job well done.

Now, I'll turn the call over to Scott to update you on our financial results and provide our financial outlook. Scott?

Scott A. Minder

Chief Financial Officer, Treasurer & Senior Vice President, Hyster-Yale Materials Handling, Inc.

Thanks, Rajiv. I'll start with high-level comments on our consolidated financial results, and then add some additional perspective on our three businesses. In the first quarter, we reported consolidated revenues of nearly $1 billion. This was an increase of 21% or $172 million over the prior year. This growth was driven by a 22% increase in lift truck sales, significantly outpacing the 5% shipment growth rate over the same period. Compared to the fourth quarter, revenues increased modestly despite lower shipments. This increase was largely due to higher prices and added parts volumes.

Bookings increased nearly 7% sequentially, topping 22,000 units, but were below the 25,200 units shipped in the first quarter 2023. As a result, our backlog dropped by 13% to 99,200 units at the end of the first quarter 2023. This compared to historically high prior-year levels. Versus year-end 2022, our backlog decreased by 3%.

Moving to earnings. The company reported a consolidated operating profit of roughly $43 million for the first quarter. This compares to an operating loss of $18 million in the first quarter of 2022. We earned a net income of $26.6 million for the first quarter versus a net loss of $25 million in the prior year. On a per share basis, first quarter 2023 earnings were $1.55 versus an earnings loss of $1.48 in the prior year.

Now, let's take a deeper look at the financial results by business. Lift Truck generated an operating profit of $47.8 million in the first quarter on sales of nearly $980 million. This better-than-expected performance resulted in a 5% operating profit margin. This compared to an operating loss of $10.7 million in the prior year. The substantial improvement was largely due to price increases that exceeded material and freight inflation in the quarter. This positive first quarter price-to-cost ratio helps to offset accumulated net inflation from 2020 and 2021. Improved sales mix, higher parts volumes, and increased fleet revenues also helped drive the favorable comparison.

Lift Truck's first quarter operating profit improved despite $5 million of unfavorable foreign currency effects and higher employee-related costs. The Lift Truck business remains vigilant over its cost, holding year-over-year cost increases to 12%, while revenues increased by almost 22%.

As Rajiv mentioned, despite a steady clearing of lower-priced backlog units over the past several quarters, our first quarter production included a large number of units booked prior to the 2021 and 2022 price increases. These units acted as a drag on our first quarter margin expansion. We expect production of these lower-margin units to decline significantly in the coming quarters as we work through the remaining aged backlog units.

Turning to Bolzoni, the business reported an operating profit of $4.4 million in the first quarter, more than double the prior year's profit. This significant improvement was driven by price increase benefits, combined with higher sales volumes and lower material, freight and manufacturing costs.

For Nuvera, the first quarter 2023 operating loss increased by $2 million year-over-year to approximately $10 million. Elevated product development costs, including those for the larger 125-kilowatt engine and higher employee-related costs accounted for the increased loss.

As you can see, we've had a strong start to 2023. As we look ahead, we expect our robust backlog to support increased year-over-year revenues and a substantial operating profit for the full year. This aligns with the commentary from our last earnings call, and Rajiv offered support for this outlook earlier.

In summary, we expect fewer components shortages and increased manufacturing efficiencies, leading to higher Lift Truck and Attachment production and shipments, lower material and freight inflation rates, and the ongoing benefits from our cost savings programs and pricing discipline to counter any additional inflation.

Finally, our strategic programs, which Al will touch on in a moment, should further enhance margins as they mature. As Rajiv pointed out, our first quarter 2023 operating profit increased by more than we anticipated. As a result, we expect second quarter operating profit to decrease from the first quarter, but remain significantly above fourth quarter 2022 levels. The expected sequential decline is partly due to anticipated mix shift towards lower-margin sales channels. Looking across 2023, we expect second half operating profit to be comparable to the first half of the year.

Moving to Bolzoni, we anticipate moderating supply chain challenges in 2023, and increased pricing to offset any additional input cost inflation. As a result, Bolzoni's margins should improve, and the business will likely generate significantly higher operating profit in 2023 compared to 2022.

Finally, Nuvera continues to ramp up product demonstrations and bookings. Sales are expected to increase in the second half of 2023 due to booked orders from current customers. Anticipated sales growth benefits are likely to be offset by higher costs. As a result, 2023's full-year operating loss should be in line with 2022's level. Taking a longer-term view, these product demonstrations provide real-world testing opportunities, and lay the foundation for future technology, adoption and improved financial returns.

Before I hand the call over to Al, I'll cover a few balance sheet items. As of March 31, the company had net debt of $496 million, including $65 million of cash. This compared to net debt of $494 million, including $59 million of cash at the end of 2022. We finished the first quarter with available borrowing capacity of approximately $186 million, slightly above year-end 2022 levels. Financial leverage measured by debt to total capital reduced by 400 basis points versus the fourth quarter, mainly due to our robust first quarter profitability.

I'll conclude my comments with a few thoughts on working capital, where we remain focused on improving inventory efficiency as our production rates increase. Last quarter, I discussed our efforts to use on-hand inventory to build trucks. As a result, our raw material and component parts inventory decreased by more than 9% in the first quarter compared with year-end 2022 levels. Despite that improvement, total inventories increased by 7% over the same time period, mainly due to increased finished goods inventory. This was a result of elevated production levels late in the quarter, leading to a high number of completed trucks left in shipping.

Lastly, the assumptions underpinning our outlook, particularly production rates, are highly sensitive to events that impact global supply chains. We're focusing on the things that we can control, and we're prepared to manage the things that we can't control. We'll keep you updated as 2023 unfolds.

Now, I'll turn the call over to Al to give his strategic perspective. Al?

Alfred M. Rankin

Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

As you heard from Rajiv and Scott, we had a strong start to the year, and we're making progress operationally and financially. Our first quarter earnings reflect the improving profit quality of our robust backlog, and we continue to have solid bookings despite softening market conditions.

Looking forward, we're nearing completion of the buildout of lower-priced, lower-margin backlog units held over from prior periods. We expect continued margin expansion, particularly in EMEA as we move through our backlog, and we expect a substantial 2023 profitability.

However, I would add a word of caution. While the year started strong and we've maintained our positive full-year outlook, there continue to be uncertainties in some areas. Those include particularly fragile EMEA supply chains, the potential for more stubborn cost inflation than expected, especially for labor, and the possibility of cost increases for some critical components. Overall, we're proceeding carefully for the remainder of 2023, and are thinking about our profitability expectations in that context.

Scott mentioned our liquidity situation, and I'd like to add my perspective on that as well. We're laser-focused on increasing our cash flows and maintaining adequate liquidity with ongoing action plans to improve future results. Our efforts to reduce inventory and generate cash are progressing, albeit at a slower pace than we'd like. However, they're expected to show substantial progress in the second half of this year as production rates increase. Inventory levels do remain elevated due to manufacturing inefficiencies caused by component shortages, largely in prior periods. We're making significant efforts to maximize the use of on-hand inventory, coupled with purchasing materials at rates below our expected production rates. Results from these actions are evident in the declining material and component inventory that Scott mentioned. However, as noted earlier, overall inventory levels are still up due to temporarily elevated finished goods inventory.

We've got very capable people from around the world focused on how to make the most units in the shortest amount of time, while maximizing the use of on-hand materials. We're collaborating with our suppliers to minimize disruptions and ensure an efficient and consistent flow of materials. Supply constraints continue to be an issue periodically, but we expect continued improvement as 2023 progresses. We're also working closely with our dealer partners to balance order delivery timing with their customers' delivery needs. It's a complex global challenge, but our teams are focused on it, and we're making progress.

While we pursue these working capital reductions, particularly inventory, we're committed to enhancing our cash flows by maintaining discipline over our cash expenditures. We do anticipate higher full-year 2023 capital expenditures compared to the significantly restrained 2022 levels. But these projected spending increases are necessary to adequately maintain our facilities and fund growth through our product development programs. Our planned spending is more heavily weighted towards the second half of the year. This was clearly evident in the fourth (sic) [first] (00:23:09) quarter since outlays were 5% of the anticipated full-year spend. We'll continue to monitor our financial and cash progress, and increase capital funds accordingly. However, we do continue to expect a significant increase in cash flow before financing activities in 2023 compared to 2022.

Executing our core strategies remains a key focus area. We're continuing to invest for long-term profitable growth over time. We're seeing solid progress toward our 7% operating profit margin goals at both the Lift Truck and the Bolzoni businesses, as we return to more normalized operating conditions. We expect this to continue in 2023 as we execute the projects underlying our core strategies. Hyster-Yale's strategies remain generally as we have described them in the past, but I want to provide a few key updates for each business.

The Lift Truck business's primary strategic focus continues to be on launching its new modular and scalable products globally, as well as projects geared toward truck electrification and implementing advanced technology capabilities. We're transforming our sales process around an industry-focused approach that better meets our customers' needs, and we continue to work to enhance our independent dealer capabilities. We continue to make progress on these programs, which include the Yale rebranding effort Rajiv mentioned earlier.

Our initial set of modular, scalable lift trucks were introduced in the EMEA and Americas markets in 2022, and we expect to introduce them to the JAPIC markets in mid-2023. The hydrogen fuel cell-powered container handler, which uses Nuvera fuel cell engines, now being tested in the Port of Los Angeles, continues to perform well. The Lift Truck business is also developing an electrified fuel cell Reach Stacker, which is expected to be delivered to the Port of Valencia, Spain in the first half of 2023 for testing.

And the Lift Truck business and Nuvera are working jointly with a large German customer to provide two Hyster electric container handling vehicles. These vehicles include the first-ever empty container handler powered by Nuvera fuel cell technology and the first Hyster Terminal Tractor in Europe. The Terminal Tractor is expected to be delivered to that customer for testing in mid-2023. Our big truck group is also exploring options for other electrified product – projects within the European Union. Beyond the Lift Truck business, Bolzoni continues to work on streamlining and strengthening its operations as a single, integrated operating entity.

Bolzoni is also focused on increasing its revenues in the Americas, while enhancing its ability to serve key attachment industries and customers in all global markets. In conjunction with this, Bolzoni is working to expand its broad industry sales, marketing and product support capabilities. Nuvera continues to focus on placing a 45-kilowatt and 60-kilowatt fuel cell engines in niche heavy-duty vehicle applications where battery-only products do not provide an adequate solution. These applications are expected to provide near-term fuel cell adoption potential. Nuvera is also focusing on developing a heavy-duty 125-kilowatt engine, which is capable of operating in more power-demanding applications.

In 2022, Nuvera announced several projects with third parties who were testing or planning to test Nuvera engines in heavy-duty applications. Additionally, Nuvera is ready to launch two new products, a 360-kilowatt and a 470-kilowatt fuel cell-powered generator, which offer a modular zero-emission power solution for commercial and industrial stationary applications. Finally, Nuvera is shifting its sales and marketing efforts to emphasize a more solution-based approach.

In summary, our first quarter results extended the momentum we generated in the fourth quarter of 2022. We expect the remainder of 2023 to continue this progress, but we have more work to do on our key strategic programs to achieve our longer-term goals. In summary, we believe we have in place the right business structure, with the right core strategies to achieve our strategic and financial goals over time.

We'll now turn to any questions you may have.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We have our first question comes from Steve Ferazani from Citadel. Steve, your line is now open.

Steve Ferazani
Analyst, Sidoti & Co. LLC

Q

Good morning, everyone. Appreciate all the detail on the call. Obviously very, very strong quarter. Trying to think through this given that you noted there was a significant portion of older-priced backlog that ran through this quarter. When we think about supply chain constraints easing and theoretically quarterly volumes pick up and your margins should be better per unit, what's the reason, and I understand caution, but what's the reason this wouldn't be the least profitable quarter of the year given that you have at least nine months of backlog still sitting there, at least?

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

Well, I think the one major item we called out in the release particularly was a shift to our customers, and we have dealers and others. And we have to be thoughtful about the mix that's generated. Some of those larger customers have large volumes, but somewhat lower margins. And so, that's a factor in our thinking here. But generally speaking, we're very optimistic about our ability to increase volume over the course of the year. You have to recognize, of course, that the third quarter is always a seasonally weak quarter.

Steve Ferazani
Analyst, Sidoti & Co. LLC
Q

Yeah.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

And I think that we just see a perspective on the full year, as I indicated, where we want to be careful and thoughtful. And I would also add that there are some projects that we need to undertake that have been deferred. And so, we'll be thinking very carefully about some of those investments in our strategic programs as we move forward over the rest of the year. So, it isn't kind of a mechanical equation that just gets generated from the volumes and others. There are a number of things that come to bear on it.

Rajiv, do you want to add anything to that?

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.
A

Sure. Steve, I think the way to think about it is we're still having to prioritize what we build based on the components we can get. And it just as it happens, this quarter we were able – or the previous quarter we were able to build a fairly rich mix, both from a channel point of view, but also geographically. And I think that's going to moderate a little bit more to our normal situation in the second quarter. And so, that's why we've kind of given this guidance. Now, again, that's our plan. What we'll actually execute again is that there's external factor of the components we can get, so.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

I would add, however, that there is one area that is moving in our favor for sure, and that is that in EMEA, that is Europe broadly defined. We have had a lot of large backlog units...

Steve Ferazani
Analyst, Sidoti & Co. LLC
Q

Yeah.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

...that we produced in the first quarter. And that will be – I think we indicated that in the earnings release. And so, we expect to see a positive trajectory in our margin structure in Europe. So, there are a lot of factors that come to bear on the equation that you're describing. But overall, we think it's a very solid story going forward.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.
A

Yeah.

Steve Ferazani
Analyst, Sidoti & Co. LLC
Q

Great. Appreciate the color. Obviously, it makes sense that backlog is coming down, you're picking up volume and the economic conditions are what they are. I guess the question, the concern would be, and it looks like we can see it in the numbers, it looks like the backlog has remained very sticky, right. That would be the risk, right, if people have to start canceling older orders. You're not seeing that yet, correct?

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc. A

No, we're not seeing cancellations. In fact, there're very, very low rates of cancellation.

Steve Ferazani
Analyst, Sidoti & Co. LLC Q

Yeah.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc. A

Yeah.

Steve Ferazani
Analyst, Sidoti & Co. LLC Q

And then, [indiscernible] (00:33:20)...

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc. A

I think...

Steve Ferazani
Analyst, Sidoti & Co. LLC Q

...in the Americas. Go ahead.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc. A

I'd just add to that I think we've described pretty clearly that our bookings have been more robust than we were expecting a quarter ago. So, our backlog has come down somewhat less. In addition, we probably shipped some number of fewer trucks, particularly those that were left in shipping that we described than we might have anticipated for the first quarter. So, those are all factors that come to bear in the equation as well.

Steve Ferazani
Analyst, Sidoti & Co. LLC Q

And how is pricing? It looks like overall backlog, ASP is up sequentially. It was down a little bit, but looks like you had at least one big order in the Americas.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc. A

I think pricing is steady. I think you can see...

Steve Ferazani
Analyst, Sidoti & Co. LLC Q

Got it.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.
A

...sequentially we went up a little bit, but I think we're in – we're where we want to be from a pricing point of view.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

I would also add that some of our prices went up more rapidly than perhaps some of our competitors who are located in different geographies. And now, those supply chain prices or costs are beginning to moderate. And we feel that that puts us in a good position as our backlogs come back to our target levels to really be highly competitive in the marketplace and return to the kinds of market share positions that we had earlier, we have clearly been careful about the orders that we're taking because we can't satisfy our customers' demands and needs with – if the backlogs – it's already tough where the backlogs are now. And if we push them out further, that's not going to be a good – that's going to be well-received by our customers and our dealers and our...

Steve Ferazani
Analyst, Sidoti & Co. LLC
Q

Right.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

So, we, if you will, are kind of careful to manage the backlog as best we can. And I think the important thing is that we want the backlog to come down, but at the same time, we don't want it to erode too fast, and we want to...

Steve Ferazani
Analyst, Sidoti & Co. LLC
Q

Yeah.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

...get through any period of market weakness. And I think an important point is that our backlogs now are extending in a number of lines well into 2024, second quarter, even third quarter of 2024 in certain situations.

So, by that time, if there's weakness in the marketplace and a significant downturn, particularly in North America, we think the backlog gives us the time to weather that, and then be in a stronger position. So, we're kind of taking all those factors into account as we book new units, and – but we're going to be ready when we get to target backlog levels, particularly in the context of our expected lower costs to be very competitive in a marketplace in terms of getting our fair share historically of the market.

Steve Ferazani
Analyst, Sidoti & Co. LLC
Q

Great. Very helpful. If I could just squeeze one more in in terms of – Al, I know you provided useful detail on cash flow clearly, and Scott, you mentioned the issue with inventory this quarter. Going forward, it's not hard even with higher CapEx to model cash conversion around 100% and significant cash flow. Am I crazy thinking that? And then, would the cash be used to repay debt?

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

Scott, why don't you take a crack at that?

Scott A. Minder
Chief Financial Officer, Treasurer & Senior Vice President, Hyster-Yale Materials Handling, Inc.

A

Yeah, sure. Yeah, Steve, I think generally speaking, you're heading in the right direction. We do see inventory coming down, maybe not as fast as we like. So, I might want to temper that expectation just a little bit. And the second part of that question, what would we do with the excess free cash flow? I think first priority would be debt reduction. I think we've noted a fairly high debt balance that we'd like to reduce, and Rajiv also mentioned about funding growth initiatives for the future to make sure we can get to those margins and maintain them with new products. I think those are the two priorities, and we maintain a pretty consistent shareholder return policy in there as well.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

I think the other thing I'd add is that, and we made this point in the earnings release and in our common comments is that, our manufacturing component inventory, raw materials and components, did come down in the first quarter. That's very significant because that's the area where we really have to get the inventory that is on-hand in line with what we need in order to produce on a consistent rate day in and day out. We had an uptick in some areas of finished goods inventory, but those trucks are not finished goods inventory of the type that is not sold and sitting there ready to be sold. Those are all trucks that have been sold and are waiting for either shipment and installation. And then, the building of those trucks or some other sort of mechanical process that delays the actual conversion cycle of those into cash.

Some customers have longer payment terms than other customers. That's a factor. But generally speaking, the area where we really want to ensure that there is consistent progress in inventory is in the component parts and the other areas. The others will work themselves out, I think. And the risk profile was extremely low on those because in terms of excess, they're not problems, they're just waiting to be turned into cash.

Steve Ferazani
Analyst, Sidoti & Co. LLC

Q

Appreciate, everyone. Thanks.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

Thanks, Steve.

Operator: Thank you, Steve. We have our next question comes from Chip Moore from EF Hutton. Chip, your line is now open.

Chip Moore
Analyst, EF Hutton Group

Q

Good morning. Thanks for taking the question. Wanted to ask about the 7% operating profit goal for the Lift Truck business. You hit 5% this quarter, so obviously looks a lot closer than it did at this time last year. Given your commentary around built-in demand and visibility and – as well as the roll out of the strategic initiatives underway, is there a way to think about maybe a potential timeline on that goal and stickiness when you get there, or maybe some type of scenario analysis depending on what we see happen to global demand here in the future?

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

Well, we're hopeful that in the quarters that lie ahead, particularly towards the end of the year, that we're going to progress significantly toward our 7% level. But as I indicated earlier, we have to be careful with that because we do have some deferred expenditures that we need to make. And one of the complications in the short term about achieving 7% is that the way – to some degree, the way we're doing that is by having somewhat lower gross profits than our targets compensated for by lower operating expense than our targets. That's been a constraint we've had in place during the COVID period. But many of those expenditures will need to be made up eventually in due course.

And as we've described, the adjusted standard margins of our products are improving and will improve over the rest of the year. But we also – and from our vantage point, as we think about target economics, we need to continue to move up the volume production scale, and as we go into 2024 and even into 2025, have the ability with our suppliers to produce at higher levels than to keep the bookings coming line by line in a way that will support that. So, that's our challenge as we look forward. And I think as you think about the 7%, you should think about it a little bit in those terms. But we do see progress. And I think the key is that the pieces of the equation are coming into line. But we do need to enhance the throughput volume as we can bring our supply base along and continue to book trucks.

Do you want to add anything to that, Rajiv?

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.

A

Sure. Chip, I mean, I think the second part of your question was how do you make it sticky? And that's where our strategic initiatives come into play. As Al said, we're a little – we prioritized the critical ones through the pandemic period. But there are some key ones that will – are critical to enabling us to make that 7% sticky. And those will be executed over the next three years or so. So, I think a combination of the things that Al talked about, and the implementation of these projects are key to sustaining that 7%.

Chip Moore
Analyst, EF Hutton Group

Q

Yeah. That's very helpful, Al and Rajiv. Appreciate it. And maybe if I can ask one on electrification [indiscernible] (00:44:49) fuel cell adoption more so I guess customer-centric what you're seeing out there, how those conversations have evolved. But it feels like commercialization is getting much closer for some of those legacy internal combustion products. But just curious what you're seeing from the customer side.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.

A

Yes, sure. We are seeing a high level of interest, especially in the segment that Al talked about, these heavy-duty applications where really battery by itself isn't going to be able to fulfill the application needs. A good example of that is port equipment, but there are others such as transit buses, kind of power generation in especially backup power generation. And we're also starting to see more traction in marine and locomotive, and Nuvera is engaged with customers globally in those segments. We feel those segments are going to be the early movers. I think we've laid out, we've got vehicles going into test programs with critical customers, and the ones that are running right now have had very positive feedback. So, very excited about the results that we're getting, as well as the growing amount of interest from customers that Nuvera is seeing.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

Yeah, let me just emphasize that last point of that, because I think Nuvera is first getting a lot more visibility of its capabilities through these demonstrations, through its outreach efforts to potential customers. And I would say from my perspective that the last, say, four, five months have seen a level of inquiry in various different market segments, which is a significant enhancement over what we've seen in the past. And I guess, inquiry isn't quite the right word. It goes beyond that. It's actual discussions of potential applications, the development of demos, a whole variety of things. But as we see things internally, we're just seeing not just the effort that the Nuvera people are making, but it's now going well beyond that and the traction from those efforts is starting to show up in a much more regular basis.

So, I think, as we said, we feel that we have follow-on bookings coming, that they are gaining momentum. And we are very hopeful that that momentum will just increase as we go through the course of this year, and begin to establish a solid base, particularly in these industries or applications that just can't get the job done with batteries only. They have to have a fuel cell in order to be electrified, as a practical matter.

Chip Moore
Analyst, EF Hutton Group
Q

Great. That's very helpful color. I'll hop back in queue. Thanks.

Operator: Thank you. [Operator Instructions] And our next question comes from Brett Kearney from Gabelli & Company. Brett, your line is now open.

Brett Kearney
Analyst, Gabelli Funds LLC
Q

Hi, guys. Good morning. Thanks for taking my question.

Christina Kmetko
Investor Relations Consultant, Hyster-Yale Materials Handling, Inc.
A

Good morning.

Brett Kearney
Analyst, Gabelli Funds LLC
Q

I want to follow up on the Nuvera momentum. It sounds like you guys have identified a new market opportunity in this potentially stationary backup power application. I guess, can you just discuss the genesis of that, how that's kind of come about? And then, I noticed you also called out opportunities to expand Nuvera's presence in EMEA and China. Just kind of what applications that is? Is that the China bus market opportunity or specific applications you're seeing there?

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.
A

Sure. So, in terms of the traction Nuvera is getting on stationary power is really coming from – the initial inquiries really came from data centers. A number of data center operators would like to shift away from ICE engine as their backup to some sort of a zero-emission solution. And we think this is a good way to do it. The other area that we are getting interest is, interestingly enough, for charging electric vehicles. So, these are both static and mobile chargers that can be used in fleet application where you have electric fleets to – because if electricity supply is a limit for fast charging, then the way to support that is have this in a stationary power that's used to charge electric vehicles. So, it's the fuel cells really being used as chargers for electric vehicles. So, those two are our big ones.

Now, in terms of China and Europe where the interest is, Europe, I would say, is widespread interest, because as you can imagine, with the Ukraine-Russia conflict, there's real focus in Europe on ensuring that they have alternative energy solutions for the medium to long term. And there's projects to explore application of fuel cells almost in each of the primary segments. And Nuvera is engaged in a number of those projects. In China, it's predominantly buses and trucks.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.
A

Yeah. Let me add one comment on the electric generators. If you think about an application in a vehicle, especially vehicles that are internal combustion engine, it is a complex and long process to redesign the drivetrain to an electric drivetrain system, and then to test the fuel cell vehicles and applications as we're doing in Los Angeles and in Valencia and other places and in Europe. The cycle time on a generator is a lot lower. That's a product that doesn't have to get integrated with the drivetrain. Rajiv mentioned the applications that seem most prevalent. But I think there's a backdrop of real interest in hydrogen, but also a realism that we'd like to do it quickly, but we can't in many applications. It takes time, and it's hard work, and there's a lot of other technologies than just the fuel cell involved.

The generator is a little different, and if you're a company that wants to demonstrate that they're making progress on being green and to begin to compare costs and drive cost down and hydrogen generation and fuel cells, if you're located in the right place with adequate hydrogen supply, you can make a commitment, particularly, as Rajiv mentioned, the data center backup. Yeah, these are big companies that are in that business, and they want to be seen as green many times. So, I think that's perhaps an important and useful distinction because obviously, from our point of view, we are searching for applications that we think have near-term potential. And that's one reason why we're focusing on these heavy-duty applications that we went through, because the batteries alone just won't get them done.

If you look at the automobile industry on the other side, from our vantage point, that's kind of way down the track in terms of adoption, because batteries alone can't do that job. There a lot of other factors that come into the batteries in terms of how they're recharged and so on and so forth. But I think that that gives you perhaps a little bit broader perspective on our efforts to find the nearest term significant volume opportunities in the marketplace that we can.

Brett Kearney
Analyst, Gabelli Funds LLC
Q

Yes. That's very helpful. And then, I just had one follow-up, more broadly on China. I believe the domestic market there, small exposure for you guys. But can you just, I guess, remind me or help me think about either between your JV in Japan, as well as through the Maximal acquisition, I guess, exposure to the China lift truck market and your outlook that you're seeing for demand in that region of the world?

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.
A

Well, I think it's a very small – we are a very small part of that market. And our focus in that market is going to evolve into larger trucks that are electrified. So, that's where the team is focused to help the heavy industries in China transition over to electrified lift truck solutions.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

I think the other factor that lies behind Rajiv's comments is that a very large portion of the existing large China market is really a very, very low-cost, low-performance vehicle. It's not an area where we think we can be competitive in the long term. It's not a focus of our efforts. We want to add more value for the customer's application and productivity. We want to be there as the Chinese market matures for sure. But there are large portions of it where, frankly, we don't think a lot of money is being made on those vehicles by anybody.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.

A

Yeah. I mean, we want to stay really focused on our brand promises, which is to really understand the customer's application and give them an optimal solution. Most customers in China are not ready for that. They just want a truck at the lowest possible cost. But now, we're starting to see these heavy industries such as paper, steel, lumber, automotive, who are now increasingly focused on productivity, emission. So, those are the customers that we're starting to heavily interact with.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

And keep in mind, too, that Bolzoni is very much involved in the Chinese market. Bolzoni has two plants in China. And they have – are able to offer their attachments. And I think we hope increasingly in conjunction with our vehicles over time, so that we're in a good position to provide customer solutions. I mean, that's the ultimate customer solution is not just a forklift truck, but a forklift truck and an attachment that gets a very specialized job done. And so, we think there is a lot of potential there in these applications that are sort of moving toward world-class sophistication or at least higher sophistication than they're currently at.

Brett Kearney
Analyst, Gabelli Funds LLC

Q

Excellent. That's very helpful. Thank you so much.

Alfred M. Rankin
Chairman & Chief Executive Officer, Hyster-Yale Materials Handling, Inc.

A

Thanks, Brett.

Rajiv K. Prasad
President, Hyster-Yale Materials Handling, Inc.

A

Thank you.

Operator: Thank you, Brett. We have no more further questions on the line.

Christina Kmetko
Investor Relations Consultant, Hyster-Yale Materials Handling, Inc.

Okay. With that, we'll conclude our Q&A session, and we'll close with a few final reminders. A replay of our call will be available online later this morning. We'll also post a transcript on the Investor Relations website when it becomes available. And if you have any questions, please reach out to me. You can reach me at the phone number on the press release. I hope you enjoy the rest of your day, and I'll turn the call back to Glenn to conclude the call.

Operator: Thank you. If you have missed any part of this call or would like to hear it again, a recording will be ready shortly. Thank you for joining today's call. Have a lovely day.